

# BUDGET LETTER

<b>SUBJECT:</b> STATE CONTRACT EXPENDITURE REDUCTIONS	<b>NUMBER:</b> 09-16
<b>REFERENCES:</b> EXECUTIVE ORDER S-09-09	<b>DATE ISSUED:</b> June 12, 2009
	<b>SUPERSEDES:</b>

TO: Agency Secretaries  
Department Directors  
Departmental Budget Officers  
Departmental Accounting Officers  
Department of Finance Budget Staff

FROM: DEPARTMENT OF FINANCE

On June 8, 2009, the Governor issued Executive Order (EO) S-09-09 concerning state contract expenditures. This Budget Letter (BL) provides state departments with instructions for implementing this EO.

<b><i>Deadlines and Deliverables</i></b>	
<b>On or before June 17, 2009</b>	<b>Departments must submit Legal Liability Exception Certifications to their Agency Secretary (or Cabinet-level Director) for current year contracts.</b>
<b>On or before June 23, 2009</b>	<b>Agency Secretaries (or Cabinet-level Directors) must submit approved Legal Liability Exception Certifications to the Department of Finance (Finance). Finance will provide final decisions by June 25, 2009.</b>
<b>On or before June 30, 2009</b>	<b>Departments must submit a 2008-09 Fiscal Year Contract Reduction Plan to Finance.</b>
<b>No later than 30 days following passage of a revised 2009-10 fiscal year budget</b>	<b>Departments must submit a 2009-10 Fiscal Year Contract Reduction Plan to their Agency Secretary (or Cabinet-level Director). Upon approval, plans must be forwarded to Finance.</b>
<b>On a flow basis, as needed</b>	<b>Departments must submit Exemption Request forms to their Agency Secretary (or Cabinet-level Director).</b>

In recognition of the 2009-10 fiscal year General Fund deficit, currently estimated to be approximately \$24 billion, EO S-09-09 requires state departments to take specific contract-related actions for both the 2008-09 and 2009-10 fiscal years, regardless of fund source. With limited exceptions, the EO S-09-09 requires departments to disencumber any contract funds encumbered on or after March 1, 2009. Until departments obtain approval of required contract-related reduction plans, EO S-09-09 prohibits departments from entering into any new contracts, amending existing contracts, or conducting specified procurement activities.

EO S-09-09 provides general and specific exemptions to its provisions, and it requires the Director of Finance to establish an exemption process for use by Agency Secretaries and Cabinet-level Directors.

## **2008-09 Fiscal Year Contracts**

Except as provided below, departments must immediately disencumber any funds encumbered on or after March 1, 2009, for contracts entered into for which goods or services have not been provided or for contracts proposed to be entered into during the 2008-09 fiscal year. These disencumbered funds must return to their original fund source. For purposes of implementing EO S-09-09, "encumbrance" means a commitment of all or part of an appropriation for goods and services not yet received.

In order for Finance to track 2008-09 fiscal year savings related to disencumbered contract funds, departments must complete the attached 2008-09 Fiscal Year Contract Reduction Plan (Attachment A) and submit it to their Finance Budget Analyst by June 30, 2009. Positive reporting is required: all departments must submit a 2008-09 Fiscal Year Contract Reduction Plan even if there are no disencumbered amounts to report.

If the disencumbrance of funds could result in a legal liability to the state, departments must obtain approval from their Agency Secretary (or Cabinet-level Director) and the Director of Finance to continue encumbrance of the funds. Departments must use the attached Legal Liability Exception Certification form for this purpose (Attachment B). Unless a department has received all required approvals to continue the encumbrance of such contracted amounts, the contracts must be disencumbered and included in the 2008-09 Fiscal Year Contract Reduction Plan. These certifications are due to Agency Secretaries (or Cabinet-level Directors) on or before June 17, 2009, and to Finance on or before June 23, 2009. Finance will provide final decisions by June 25, 2009.

Funds encumbered prior to March 1, 2009 are not subject to EO S-09-09.

## **New 2008-09 and 2009-10 Fiscal Year Contracts**

Effective immediately, and until a department's 2009-10 Fiscal Year Contract Reduction Plan (see below) is approved by the Agency Secretary or Cabinet-level Director, a department is prohibited from entering into any new contracts, amending existing contracts, issuing purchase orders for goods or services, or making purchases from statewide master agreements or leveraged procurement agreements for goods or services.

## **2009-10 Fiscal Year Contract Reduction Plans**

Within 30 days after passage of a revised budget for the 2009-10 fiscal year, all departments, regardless of funding source, must submit a 2009-10 Fiscal Year Contract Reduction Plan (see Attachment D) to their Agency Secretary or Cabinet-level Director. Each department reduction plan must include a 15 percent reduction of the amount of the department's appropriation to be encumbered by new contracts, extended contracts, or purchases from statewide master contracts in the 2009-10 fiscal year, unless exemption is anticipated based on the Exemption Criteria Decision Model (see Attachment C). The reduction may be achieved by any combination of cancellation, suspension, renegotiation, or other method. Departments must use the attached form to submit the 2009-10 Fiscal Year Contract Reduction Plan. While the 2009-10 fiscal year budget is being revised, departments are strongly encouraged to complete the reduction plan as soon as possible to avoid delays in processing critical contracts. Departments may use the budget amounts as of 2009-10 May Revision to estimate contract reduction amounts. Upon approval, Agency Secretaries and Cabinet-level Directors must submit 2009-10 Fiscal Year Contract Reduction Plans to Finance.

## **Exemptions and Exemption Process**

EO S-09-09 provides for a number of general and specific exemptions. EO S-09-09 does not apply to local assistance funds, grants for local assistance purposes, or interagency agreements. It also does not apply to services and functions of state government directly related to the preservation and protection of human life and safety, including but not limited to emergency and disaster response activities and the provision of 24-hour medical care.

Following approval of 2009-10 Fiscal Year Contract Reduction Plans, departments should continue to submit Exemption Request forms (see Attachment F) for amounts to be encumbered for any new contracts, extended contracts, or purchases from statewide master contracts in the 2009-10 fiscal year that were not included in the approved 2009-10 Fiscal Year Contract Reduction Plan.

### **Exemptions Applicable to Contracts in the 2008-09 Fiscal Year Only**

The provisions of EO S-09-09 do not apply to projects that are funded by the American Recovery and Reinvestment Act, or projects funded by bonds, grants or projects specifically mandated by court orders, or public-private partnerships that require no direct state expenditures. Because EO S-09-09 does not apply to such contracts in the 2008-09 fiscal year, no exemption is required. For the 2009-10 fiscal year, such contracts would likely meet the exemption criteria described below.

### **Exemptions Applicable to Contracts in Both the 2008-09 and 2009-10 Fiscal Years**

Exemptions may be based on the following circumstances:

- An emergent situation to preserve and protect human life and safety.
- The avoidance of a significant revenue loss (including the loss of federal funds).
- The realization of significant net cost savings.
- Contracts for maintaining multi-year information technology systems and information technology services approved by the Office of the Chief Information Officer (OCIO). The OCIO will be releasing a contract approval form, which must be approved by the OCIO prior to the submittal of relevant exemption requests to Agency Secretaries or Cabinet-level Directors.
- The provision of critical services and functions.

All contract-related funds encumbered on or after March 1, 2009 are subject to the provisions of EO S-09-09, unless a department received an exemption from its Agency Secretary or Cabinet-level Director. In order to obtain approval for an exemption for any project, contract, or encumbered amount, departments must submit the attached Exemption Request form (see Attachment F) to their Agency Secretary or Cabinet-level Director.

Agency Secretaries and Cabinet-level Directors should use the attached Exemption Criteria Decision Model to determine whether Exemption Requests should be approved.

## **Summary of Attachments**

There are six attachments to this BL to assist departments in meeting the requirements of EO S-09-09. The purpose of each of these documents is summarized below.

Attachment A: 2008-09 Fiscal Year Contract Reduction Plan. This form is to identify 2008-09 fiscal year savings attributable to the disencumbrance of funds pursuant to EO S-09-09. The form should include all affected contracts, the fund code, and the reduction amount. Amounts related to exempted contracts

should be excluded from this plan. Departments should use additional sheets, if necessary. Alternatively, departments can provide the same information in a different format and use the 2008-09 Fiscal Year Contract Reduction Plan form as a cover sheet. Departments should submit the completed form to their Finance Budget Analyst by June 30, 2009.

Attachment B: Legal Liability Exception Certification. In some cases, disencumbering funds pursuant to EO S-09-09 could result in a legal liability. In such cases, departments should submit a Legal Liability Exception Certification form to their Agency Secretary or Cabinet-level Director by June 17, 2009. Departments should provide a description of the contract, the amount of funds that need to be re-encumbered, and a description of the potential legal liability to the state from their disencumbrance. Upon approval, Agency Secretaries and Cabinet-level Directors should forward the form to Finance on or before June 23, 2009. Finance will provide final decisions by June 25, 2009. In cases where a delay in funding could result in legal liability, departments may request expedited processing of the Legal Liability Exception Certification form. Upon Finance approval, departments may re-encumber the funds without seeking exemption approval. This form may be used only for funds encumbered on or after March 1, 2009, and disencumbered pursuant to EO S-09-09.

Attachment C: Exemption Criteria Decision Model. Agency Secretaries and Cabinet-level Directors should use this document to evaluate Exemption Requests submitted by departments. See the summary for Attachment F below for a description of actions to be taken by departments following Agency Secretary and Cabinet-level Director decisions.

Attachment D: 2009-10 Fiscal Year Contract Reduction Plan. This document provides Agency Secretaries, Cabinet-level Directors, and Finance with a plan to reduce department 2009-10 appropriations for non-exempt new contracts, extended contracts, and purchases from statewide master contracts, regardless of fund source. Departments must submit plans to Agency Secretaries or Cabinet-level departments for approval no later than 30 days following passage of a revised 2009-10 fiscal year budget. The form should include the amount to be encumbered in the 2009-10 fiscal year and the amount exempted (see Attachments C and F). A factor of 15 percent is applied to the net, non-exempted amount to derive the Contract Reduction Amount for the department. Departments should complete the Reconciliation by Fund Source at the bottom of the form, summarizing the result of Attachment E (see below) by fund name, fund code, and reduction amount. This form must be approved by the Agency Secretary or Cabinet-level Director. Until the form is approved, departments are prohibited from entering into any new contracts, amending existing contracts, issuing purchase orders for goods or services, or making purchases from statewide master agreements or leveraged procurement agreements for goods or services.

Attachment E: 2009-10 Fiscal Year Contract Summary Listing. Departments must submit this spreadsheet in support of the information provided in the bottom section of Attachment D. The completed form should include data for all planned contract-related funding for the 2009-10 fiscal year. This includes the contract name and description, contract number, contract amount, 2009-10 reduction amount (if any), fund code, whether the funding is exempt from EO S-09-09 (Y or N), and the exemption code or codes, if applicable (a key to the exemption codes is provided on a separate tab). Alternatively, departments can provide the same information in a different format and use the 2009-10 Fiscal Year Contract Summary Listing form as a cover sheet.

Attachment F: Exemption Request. Departments must use this form to seek exemptions for all new contracts, extended contracts, and purchases from statewide master contracts, regardless of funding source. The completed form should be submitted to the Agency Secretary or Cabinet-level Director, as appropriate, on a flow basis. Departments should provide basic information about the contract and describe how the contract meets the exemption criteria in EO S-09-09. Agency Secretaries and Cabinet-

level Directors should evaluate the requests using the Exemption Criteria Decision Model. The evaluation should lead to one of the following decisions:

- *No exemption required.* In some cases, departments may submit Exemption Requests while waiting for approval of a Legal Liability Certification form. If the Legal Liability Certification form has already been approved by the Agency Secretary (or Cabinet-level Director) and Finance, no exemption is required and the department may re-encumber the amount.
- *Approval.* The signed Exemption Request form should be returned to the department. The department should exclude exempted amounts from its 2008-09 Fiscal Year Contract Reduction Plan and from its 2009-10 Fiscal Year Contract Reduction Plan, as appropriate. Upon approval of the Exemption Request, departments should re-encumber any amounts previously disencumbered pursuant to EO S-09-09.
- *No approval needed.* The unsigned Exemption Request form should be returned to the department with the notation "No Approval Needed. Already Exempt." The department should take the same action as if the request had been approved. In the case of contracts for which no approval is needed, Agency Secretaries may authorize departments to make this determination without submitting Exemption Request forms. However, these contracts should still be included in the 2009-10 Fiscal Year Contract Summary Listing.
- *Denial.* If the request is denied, the unsigned request form should be returned to the department with the notation "Denied" and the department should include the amounts in its Contract Reduction Plans for the 2008-09 and 2009-10 fiscal years, as appropriate. If an exemption request is denied, a department can still execute the contract, but it must do so within the funding restrictions imposed by EO S-09-09.

### **Application to Other Entities of State Government**

While the provisions of EO S-09-09 do not apply to entities of California Government not under the Governor's direct executive authority, it is requested that such entities implement similar or other mitigation measures to achieve budget and cash savings and additional transparency in state government. These entities include constitutional officers, the California Public Utilities Commission, the University of California, the California Community Colleges, the legislative branch of government (including the Legislative Counsel Bureau), and the judicial branch of government.

If you have questions regarding this BL, please contact your Finance Budget Analyst.

/s/ Fred Klass

FRED KLASS  
Chief Operating Officer

Attachment